

STRICTLY CONFIDENTIAL (FR) CLASS I-FOMC

*Materials for
Staff Presentation to the
Federal Open Market Committee*

February 11, 1986

Principal Assumptions

Monetary Policy

- Growth of M1 near 7 percent in 1986 and around 6 percent in 1987.
- Growth of M2 in the range of 7 to 8 percent in 1986 and 1987.

Fiscal Policy

- Deficit-reducing actions of about \$15 billion for FY 1986 budget and an additional \$30 billion for FY 1987 budget.

Foreign Exchange Value of the Dollar

- Moderate further decline over the course of the projection.

Oil Prices

- Oil import prices average around \$20 per barrel in 1986 and 1987.

Federal Budget, Fiscal Years

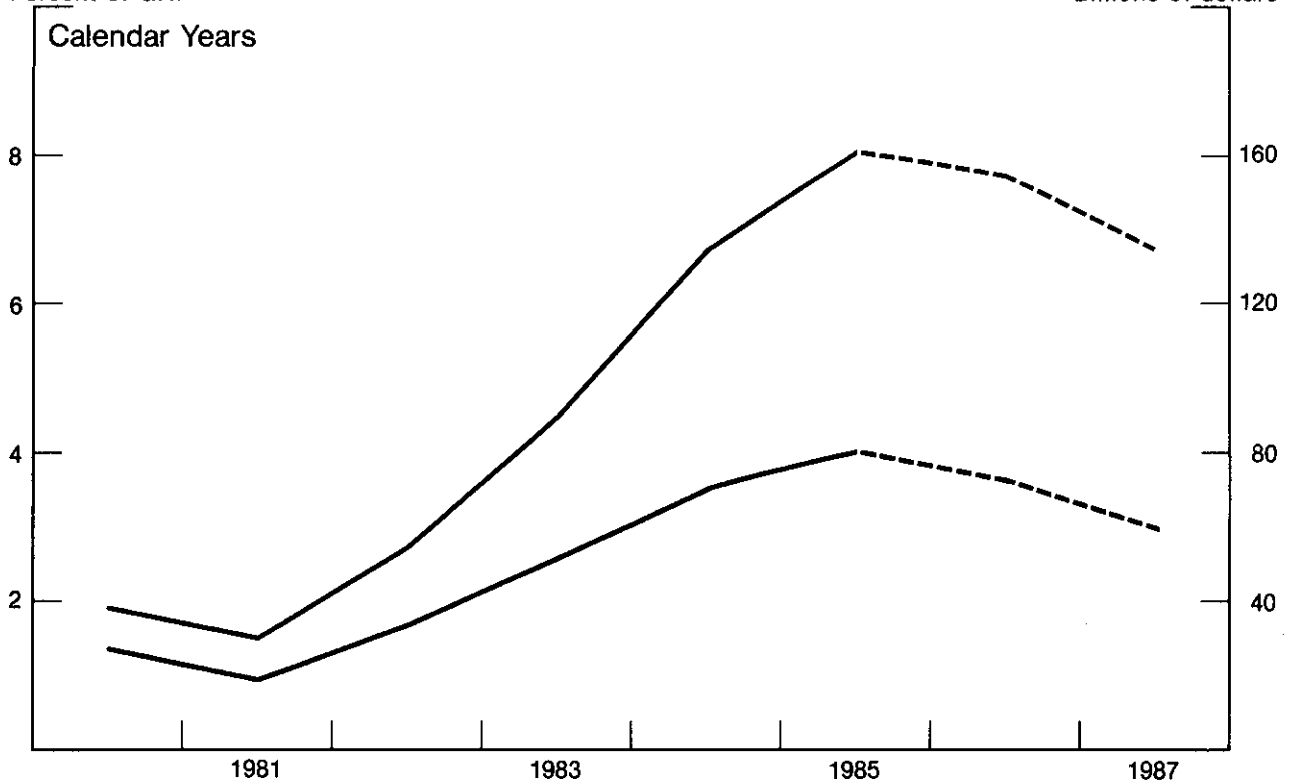
	<u>1985</u> Actual	<u>1986</u> Staff Administration		<u>1987</u> Staff Administration	
Outlays	946	978	980	1,001	994
Receipts	734	777	777	834	850
Deficit	212	201	203	167	144

Structural Deficit

Percent of GNP

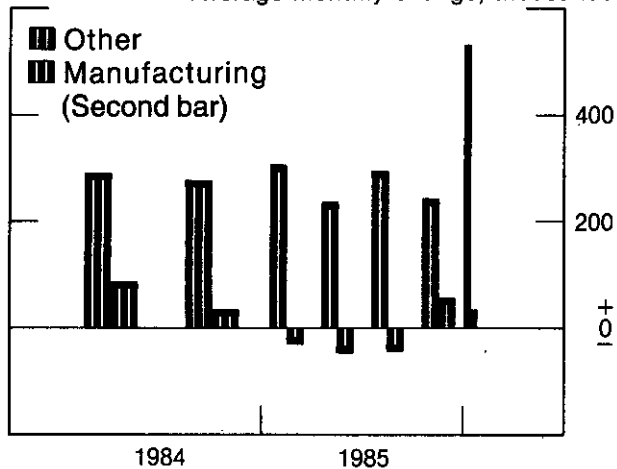
Billions of dollars

Calendar Years

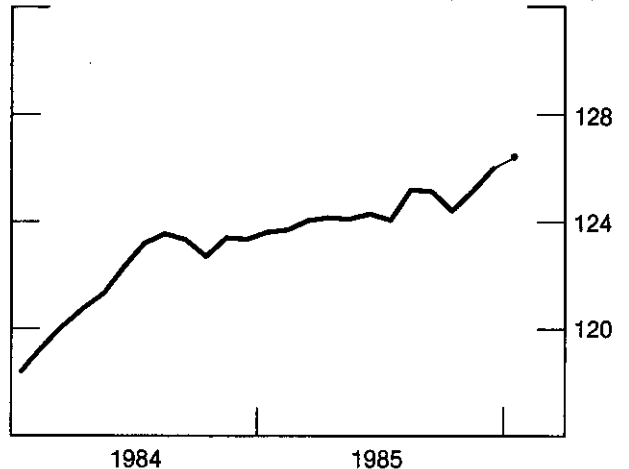


Nonfarm Employment

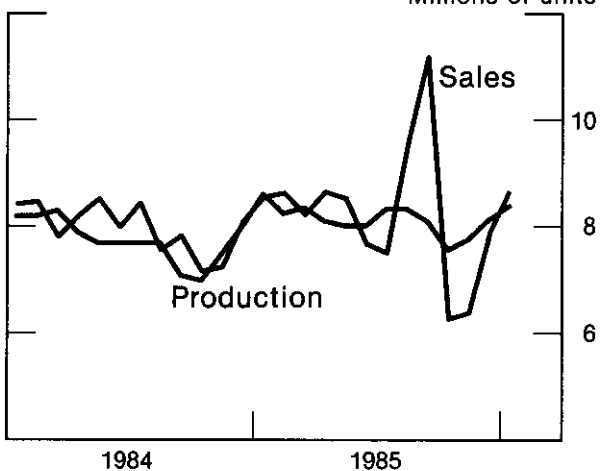
Average monthly change, thousands

**Industrial Production**

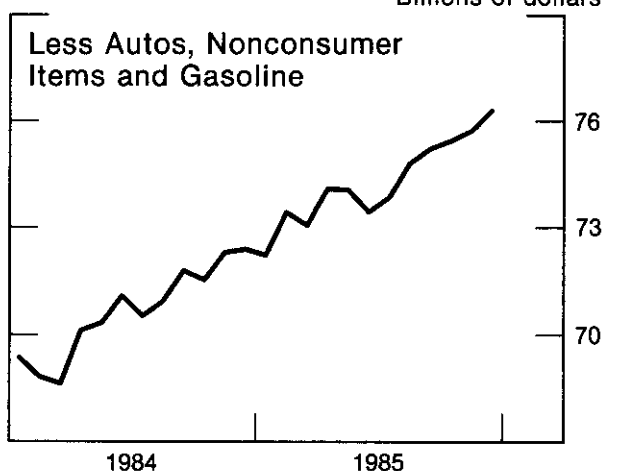
Index 1977 = 100

**Domestic Auto Sales and Production**

Millions of units

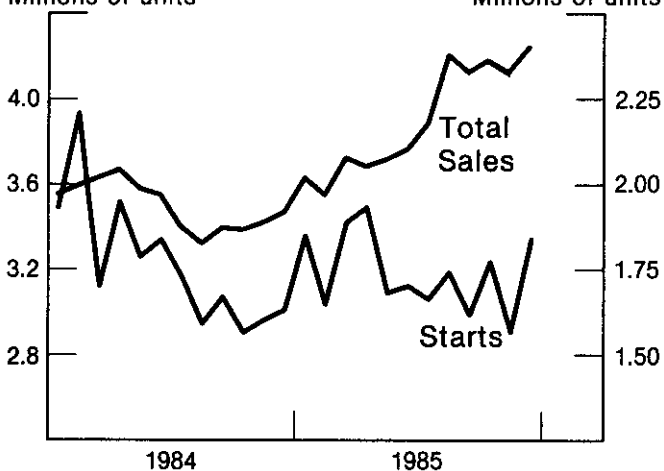
**Retail Sales**

Billions of dollars

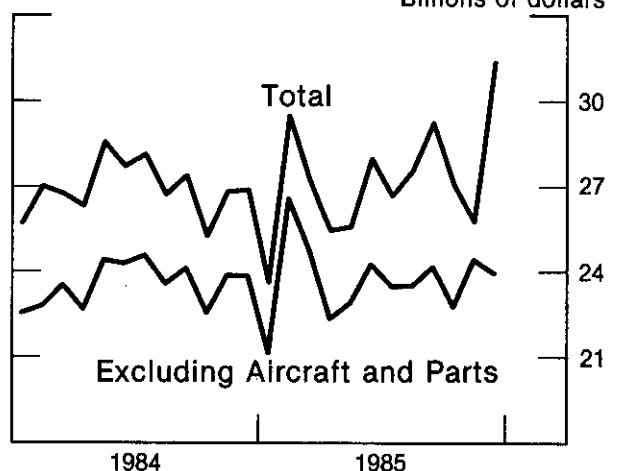
**Housing Starts and Sales**

Millions of units

Millions of units

**New Orders for Nondefense Capital Goods**

Billions of dollars



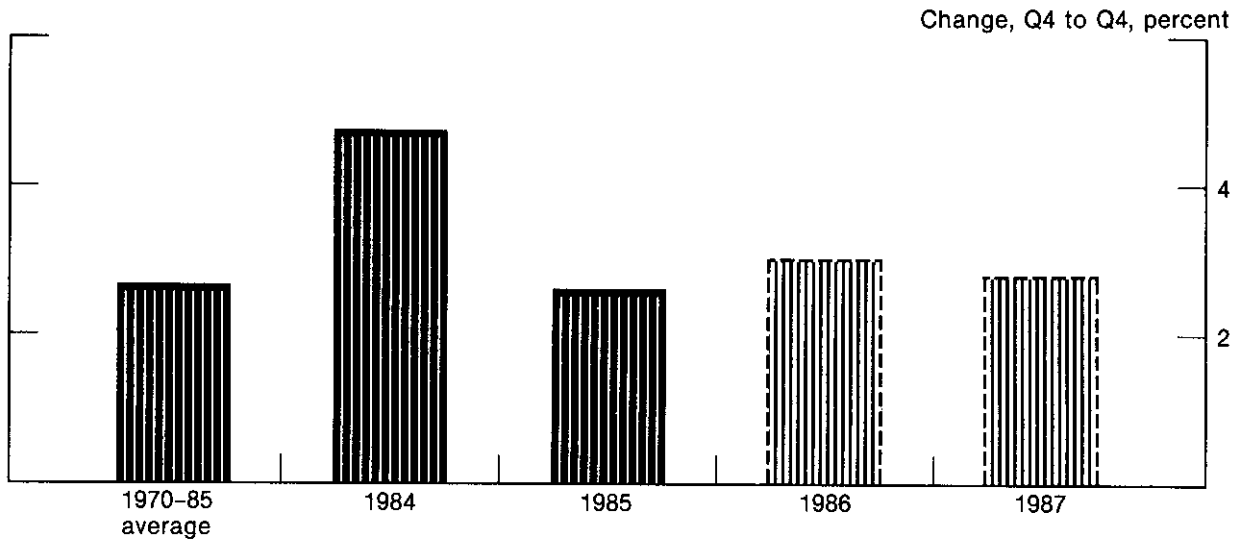
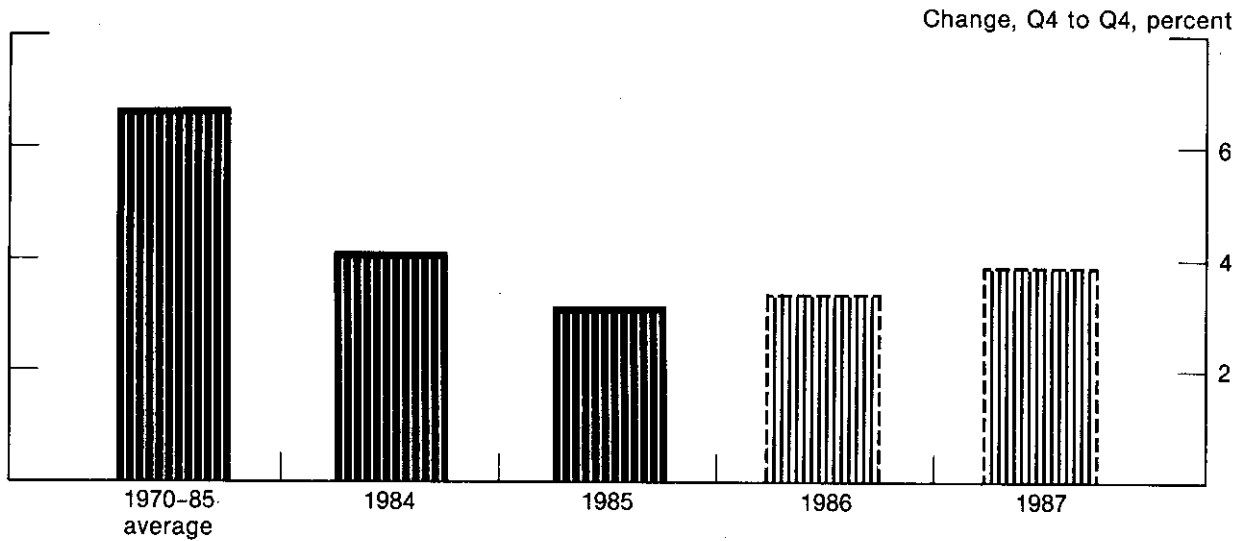
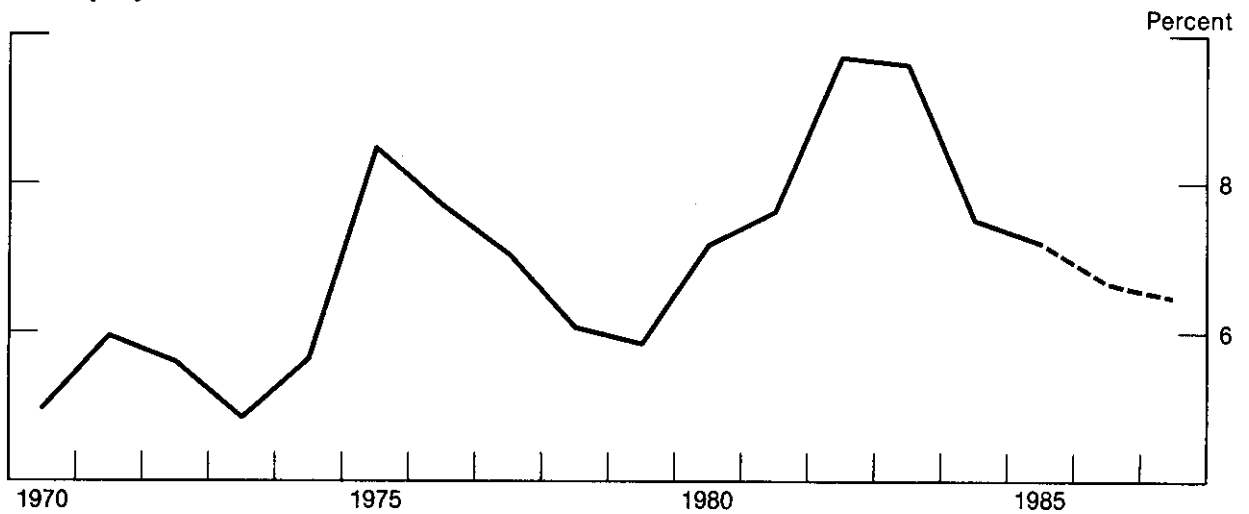
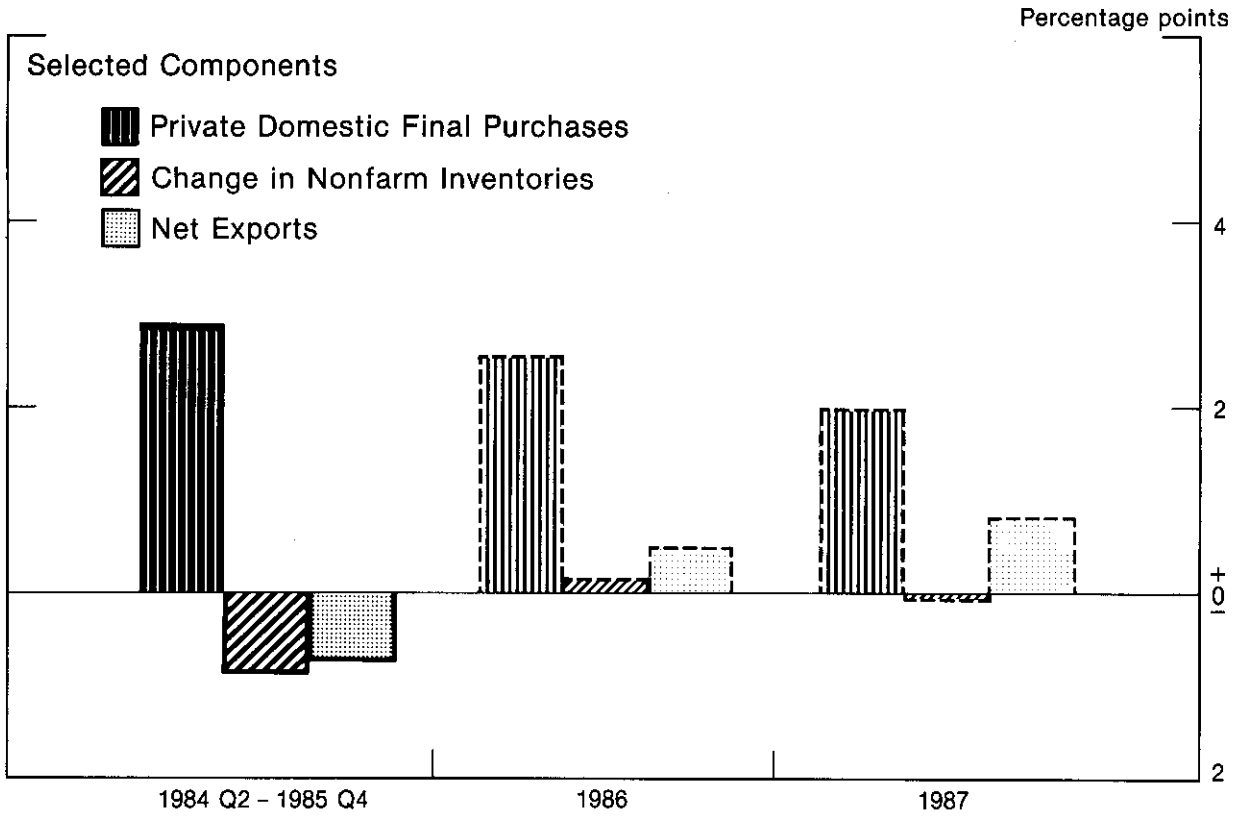
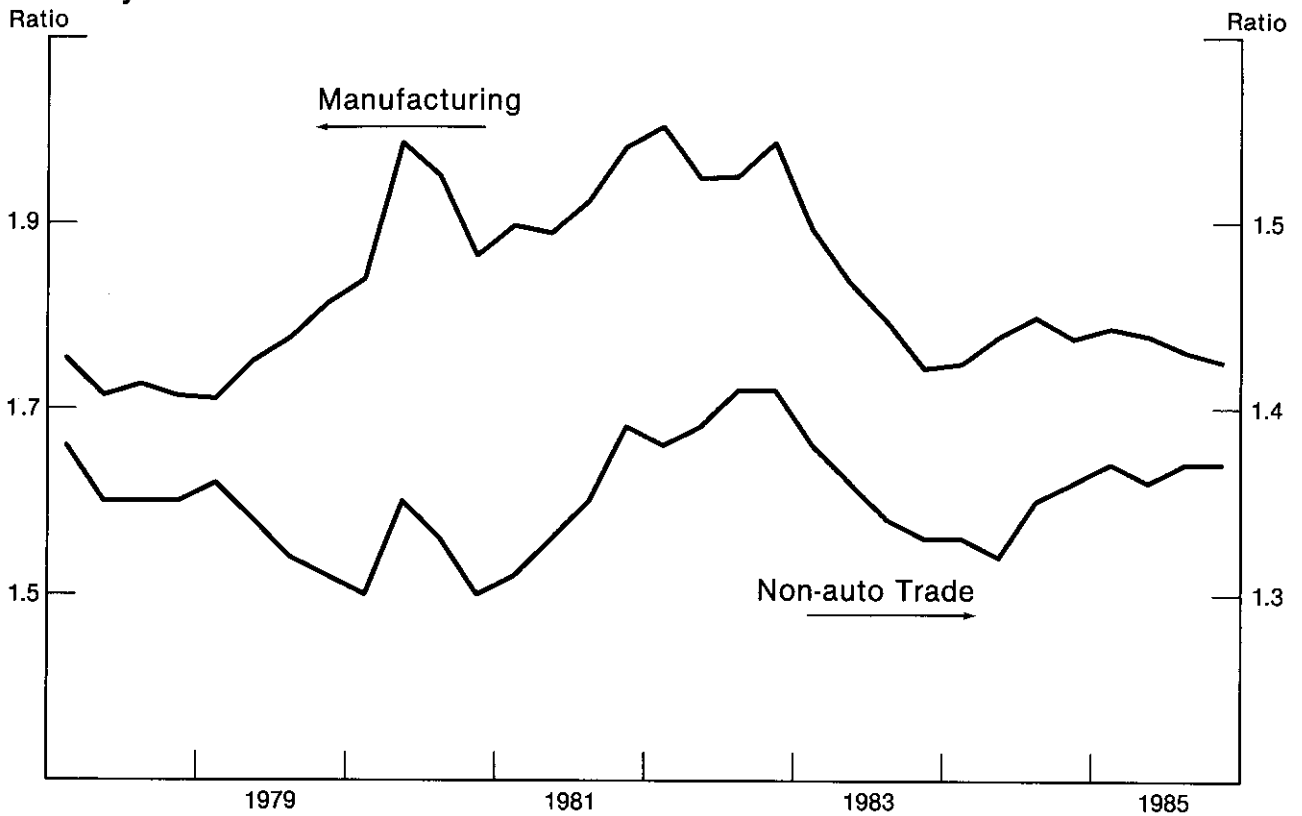
Real GNP**GNP Deflator****Unemployment Rate**

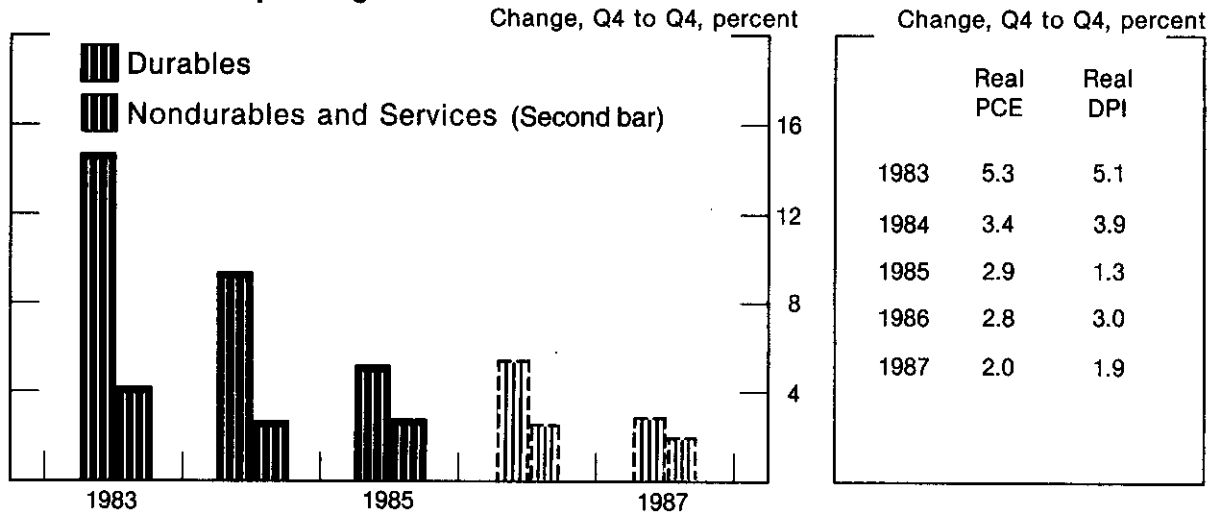
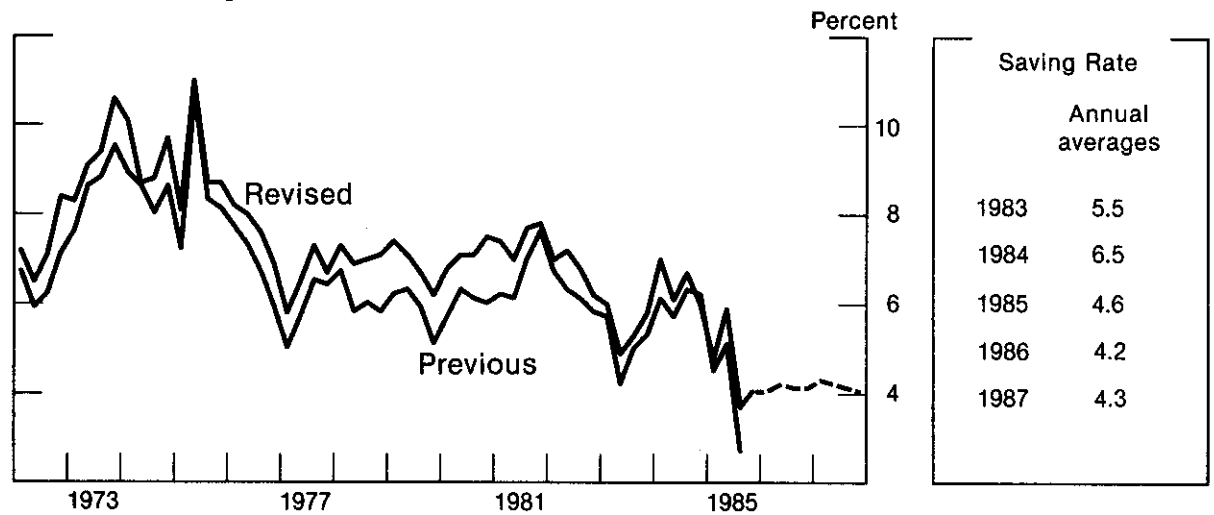
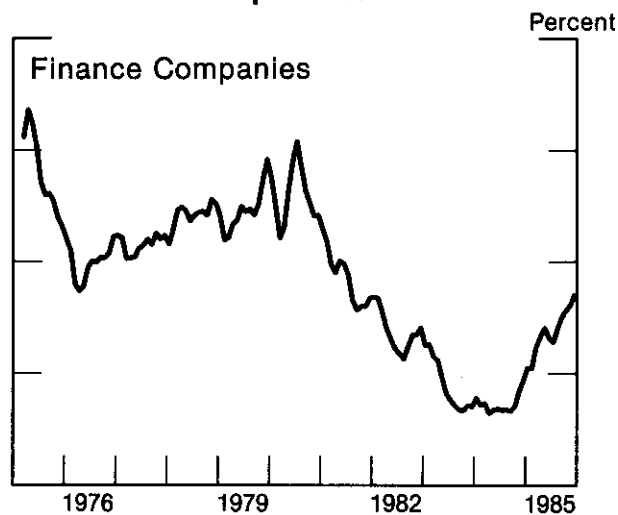
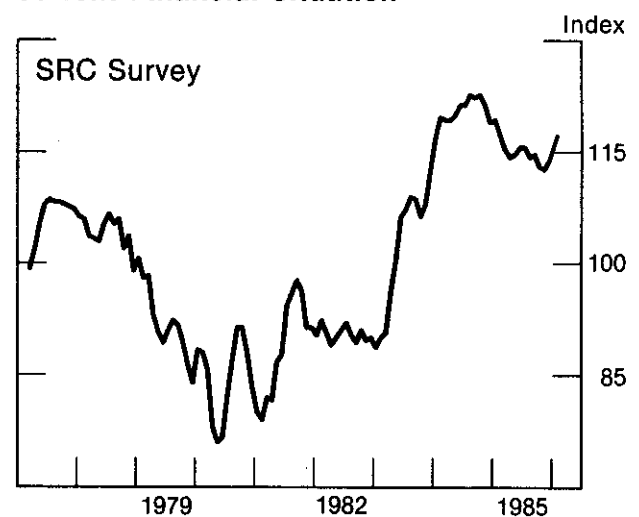
Chart 5

Contributions to Real GNP Growth

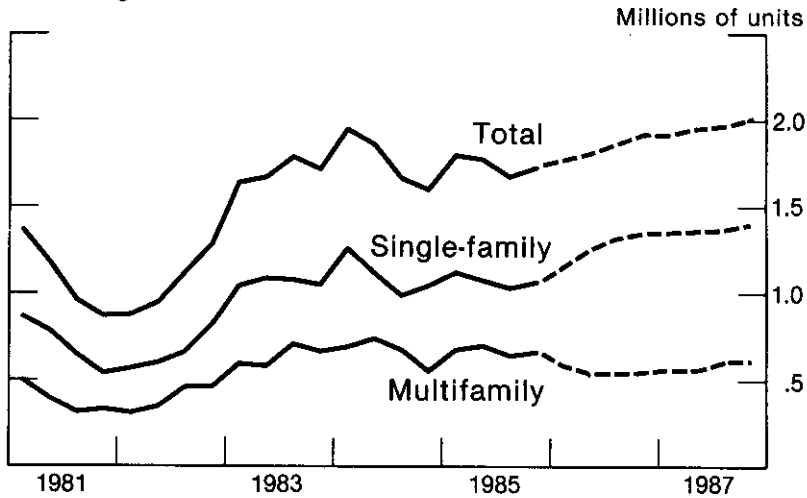


Inventory-Sales Ratio



Real Consumer Spending**Personal Saving Rate****Auto Loan Delinquencies****Current Financial Situation***

*Compared to a year ago. Better minus worse plus 100.

Housing Starts**Total Starts**

Millions of units	
1983	1.70
1984	1.77
1985	1.74
1986	1.82
1987	1.96

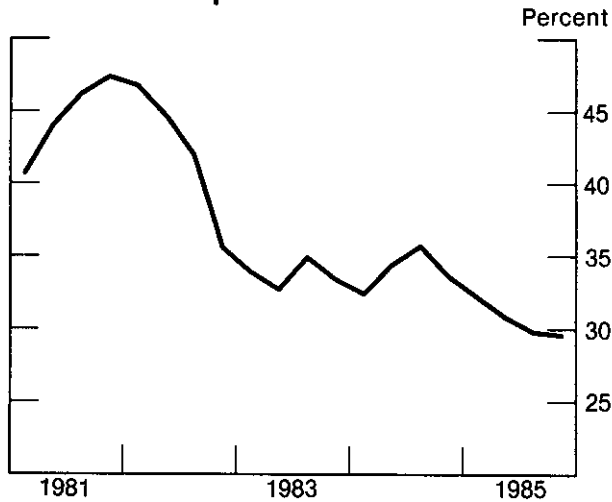
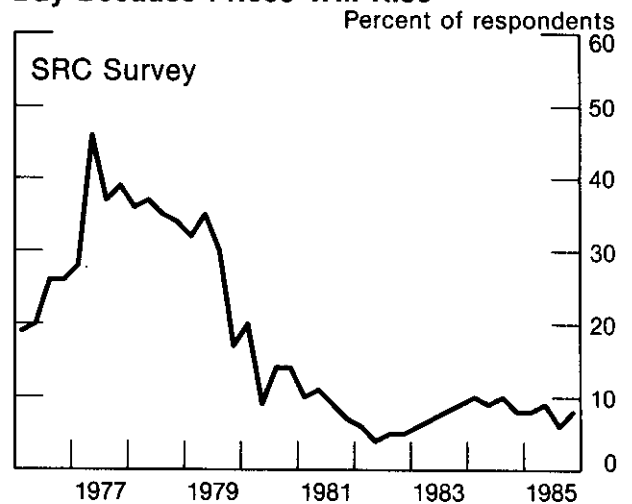
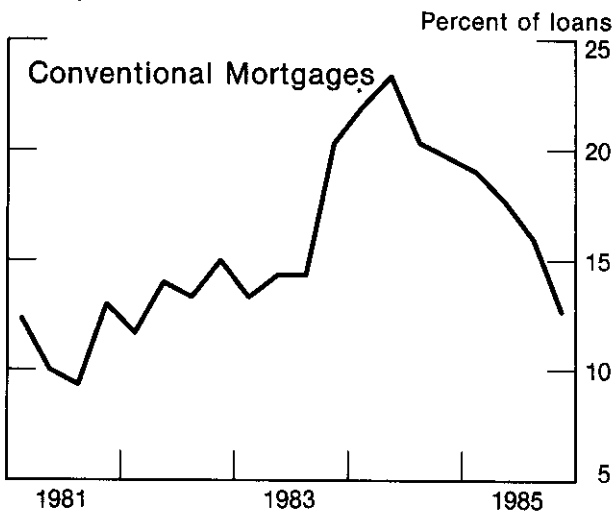
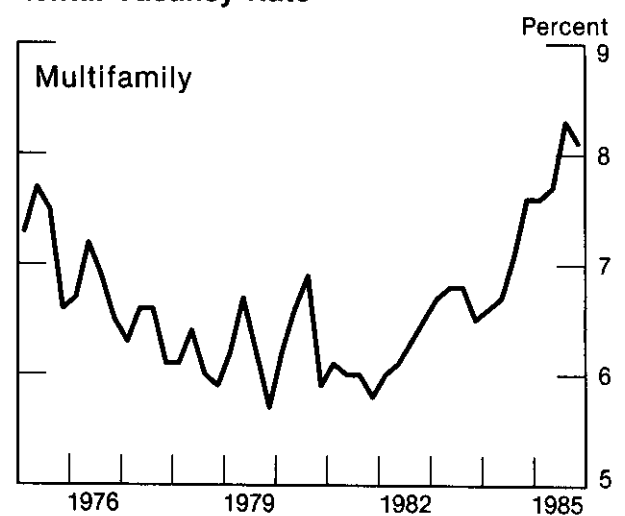
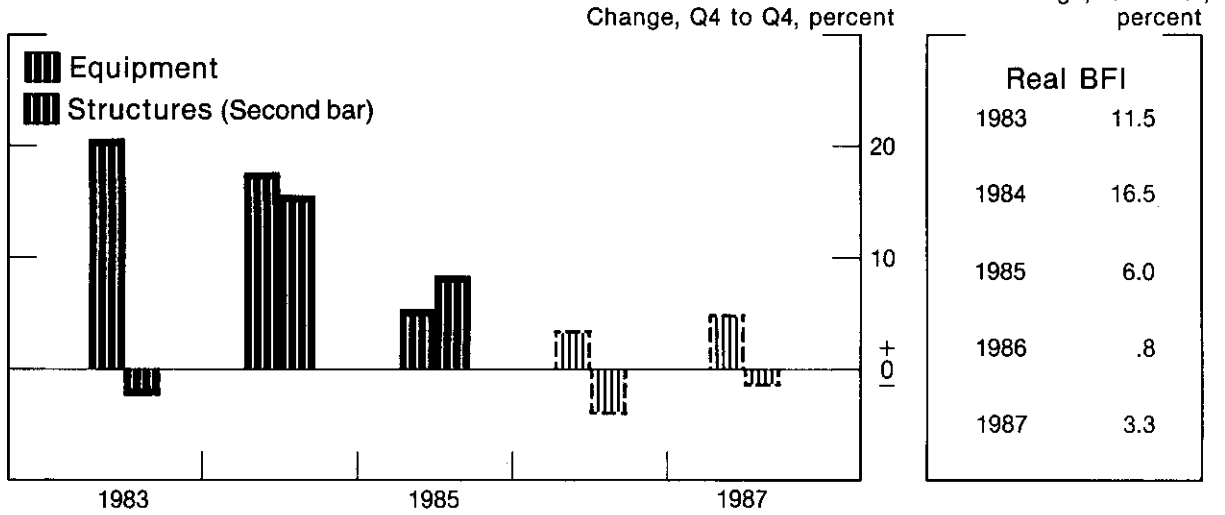
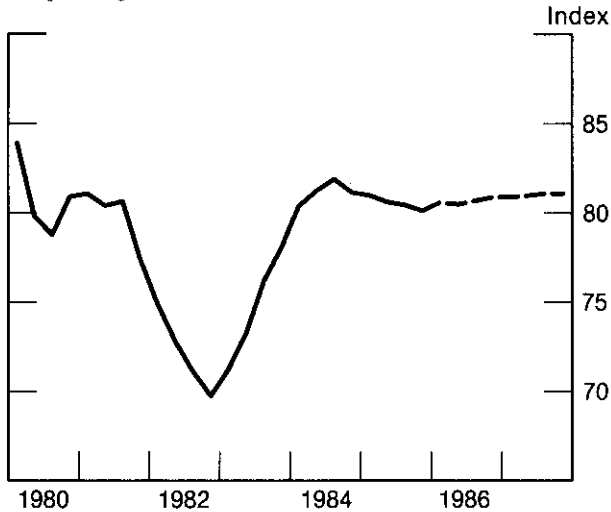
Mortgage Payment as Percent of Disposable Income**Buy Because Prices Will Rise****Loan/Value Greater Than 90%****Rental Vacancy Rate**

Chart 8

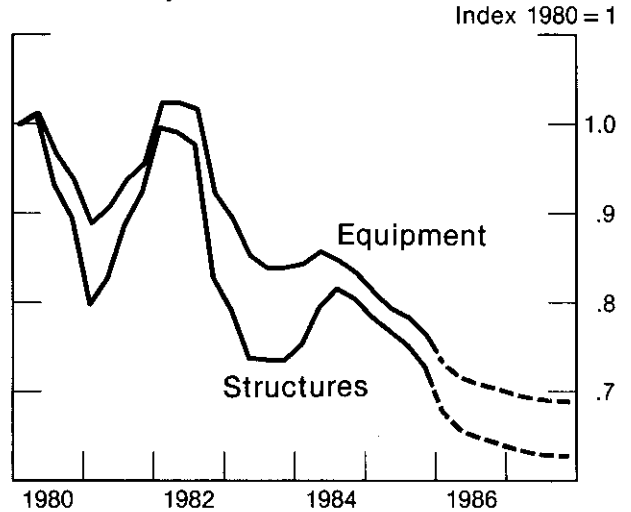
Real Business Fixed Investment



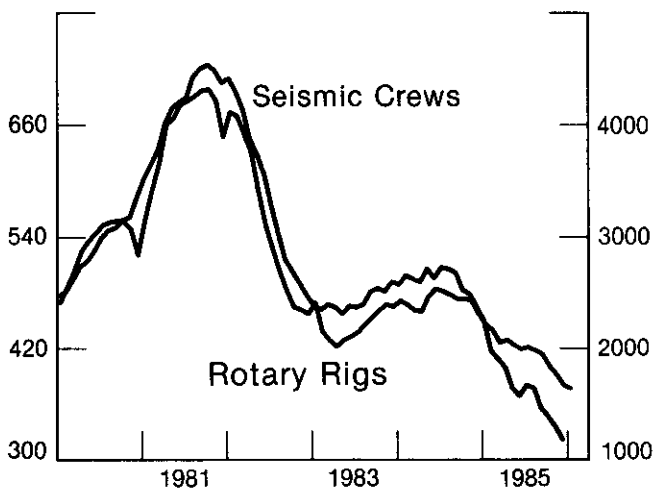
Capacity Utilization



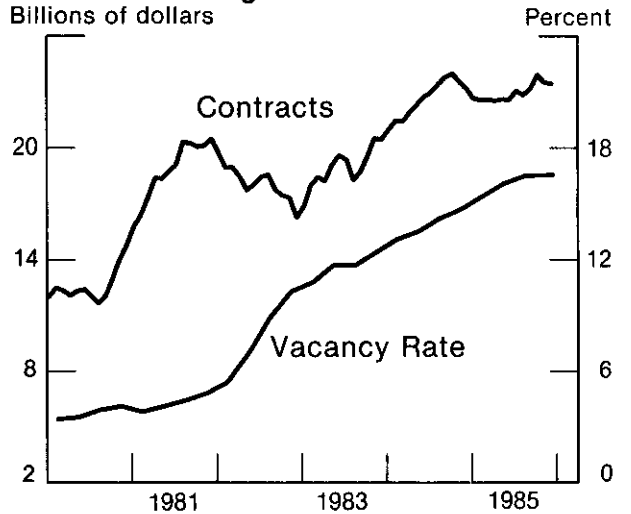
Cost of Capital



Oil Drilling

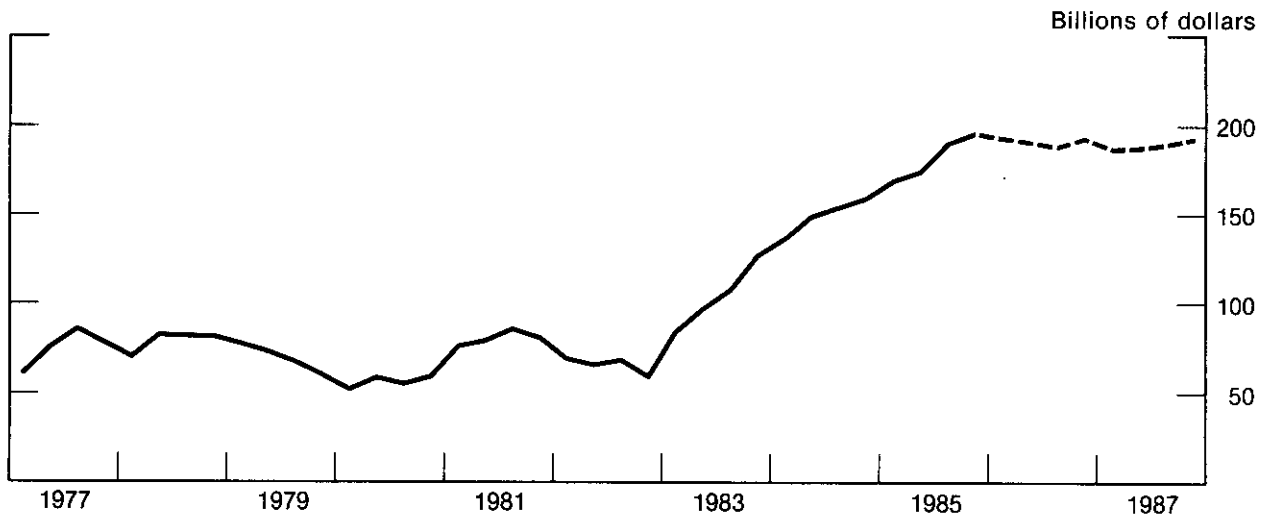


Office Building



Nonfinancial Corporations

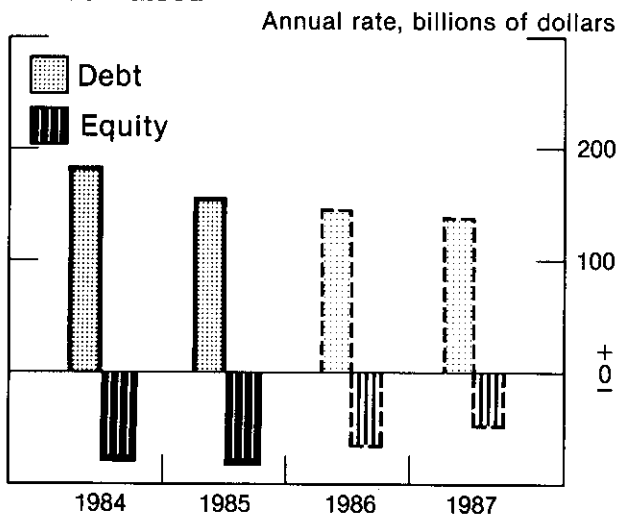
Profits After Tax (Economic)



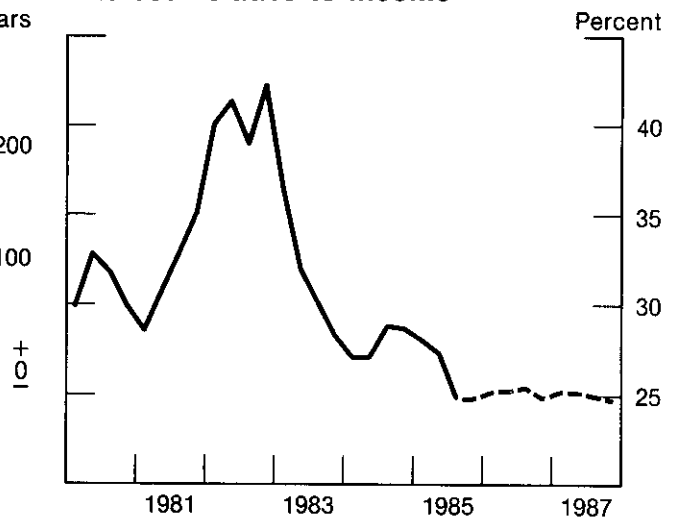
Ratio of Capital Outlays to Internal Funds



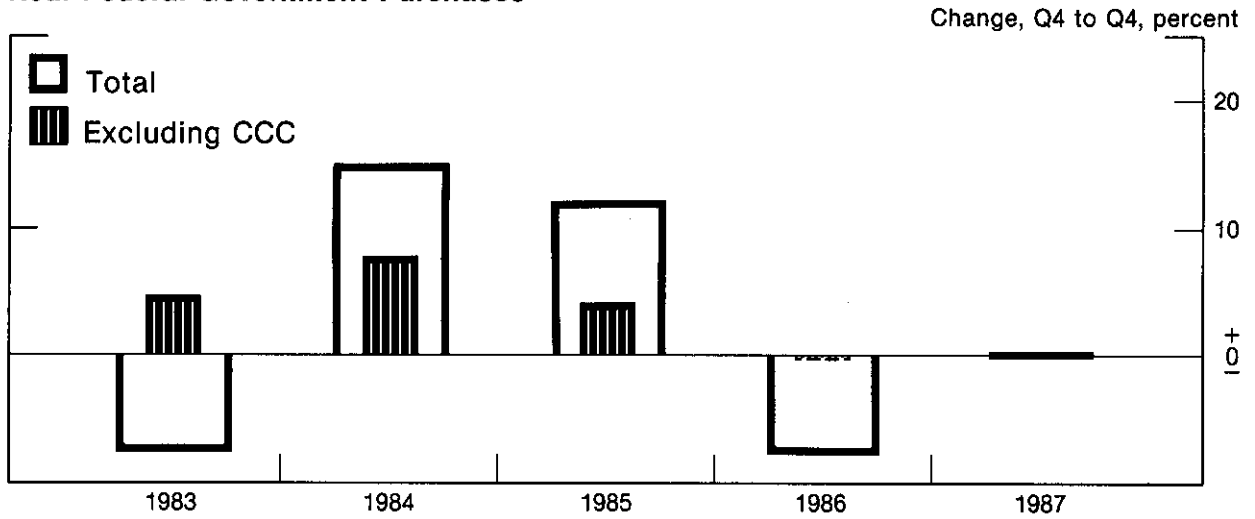
Funds Raised



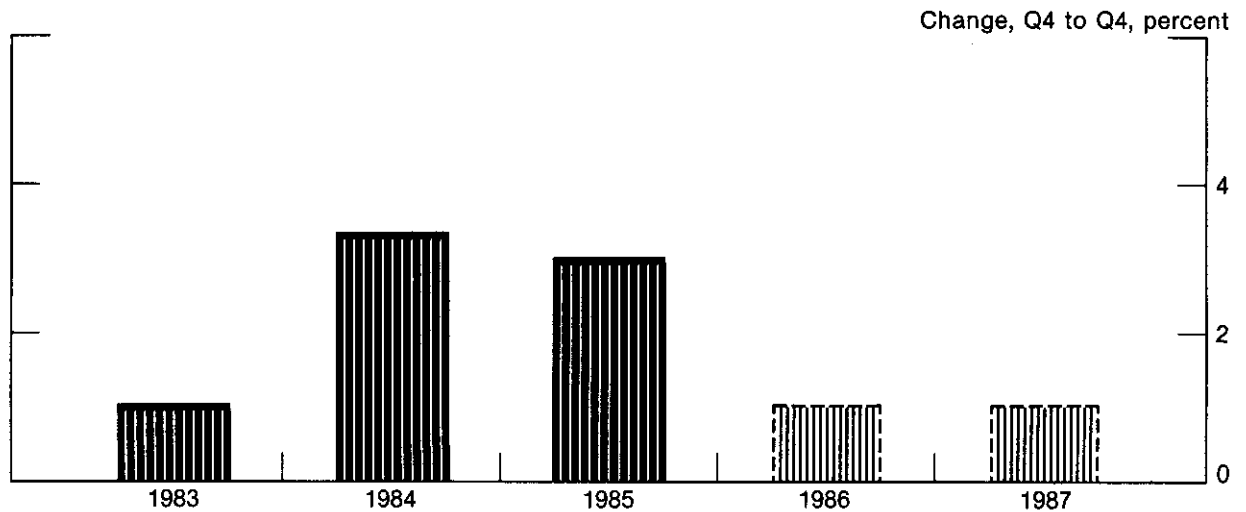
Interest Relative to Income



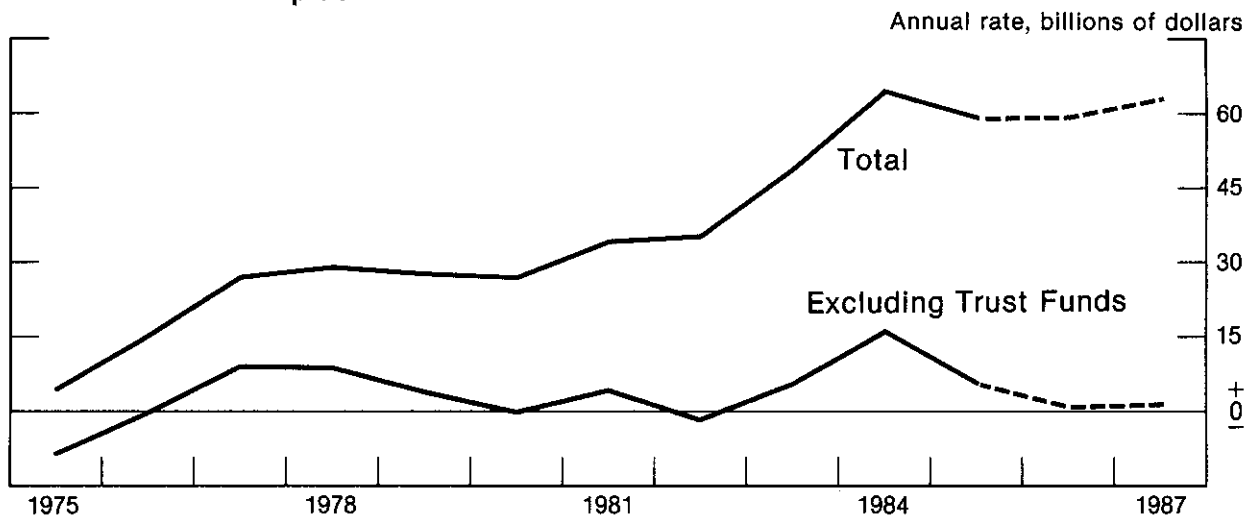
Real Federal Government Purchases



Real State and Local Government Purchases

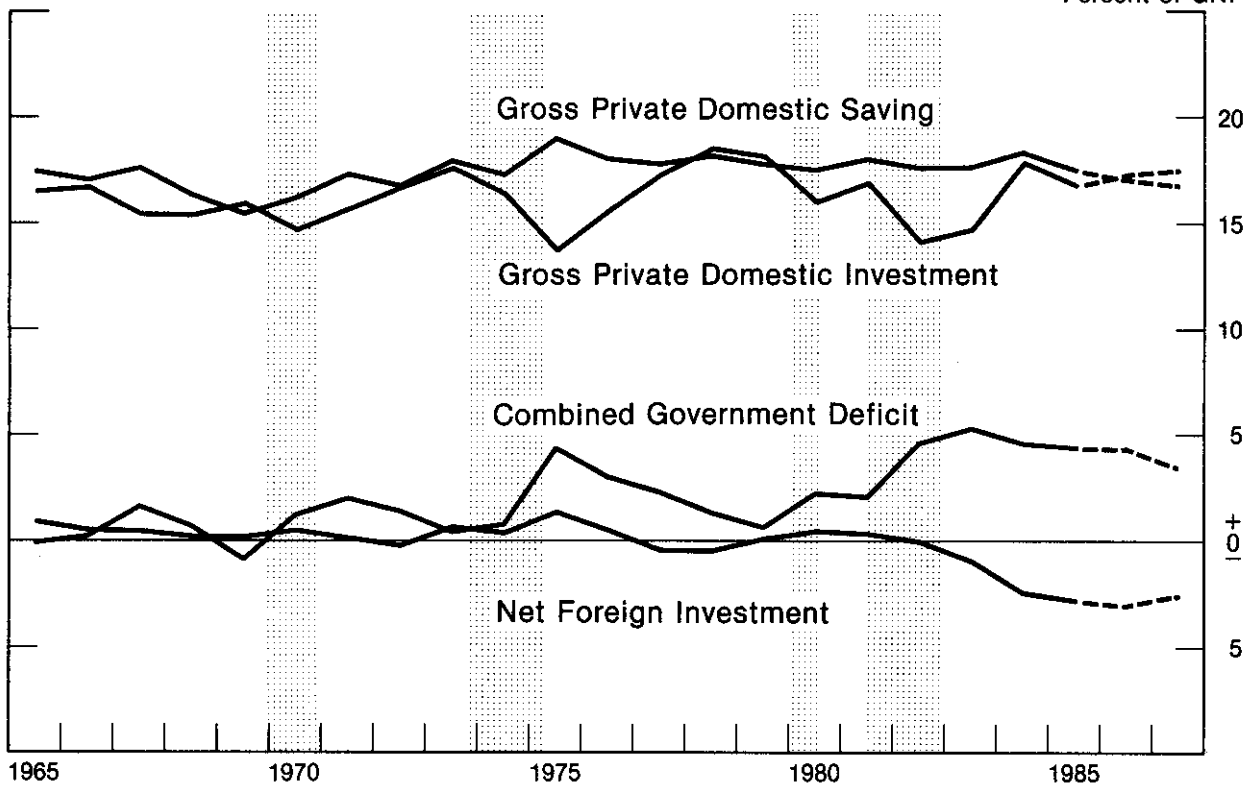


State and Local Surplus



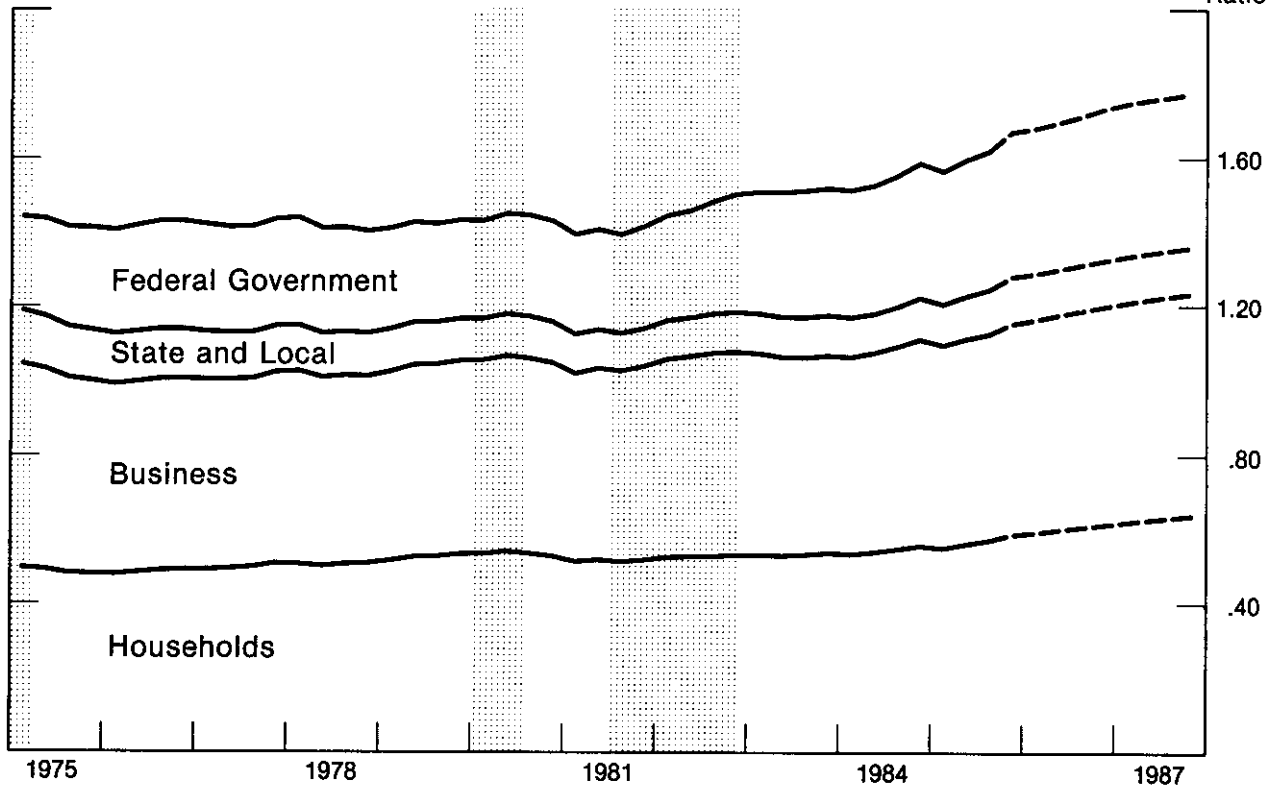
Sectoral Saving Flows

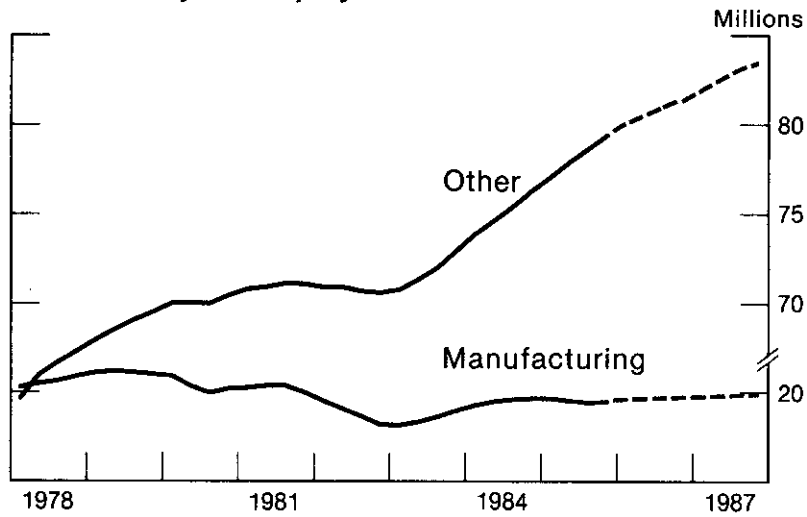
Percent of GNP



Debt Relative to GNP

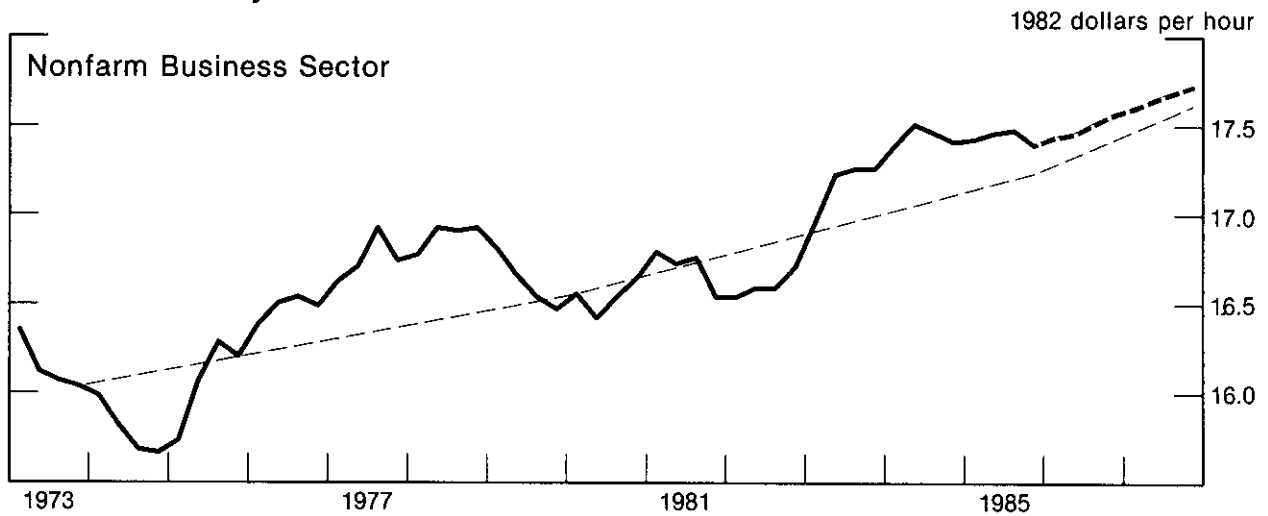
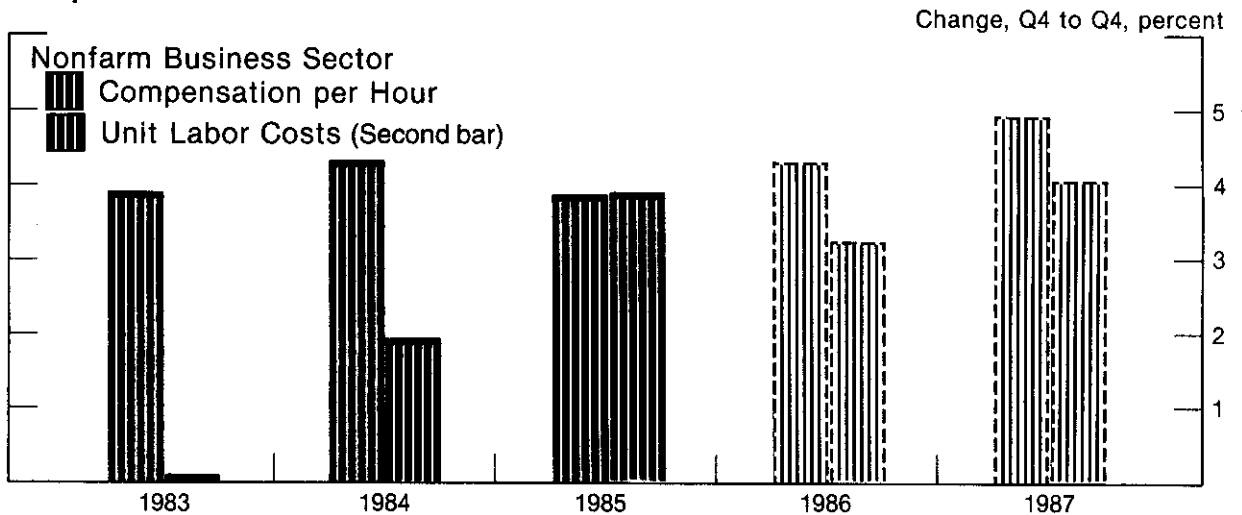
Ratio



Nonfarm Payroll Employment**Total Employment**

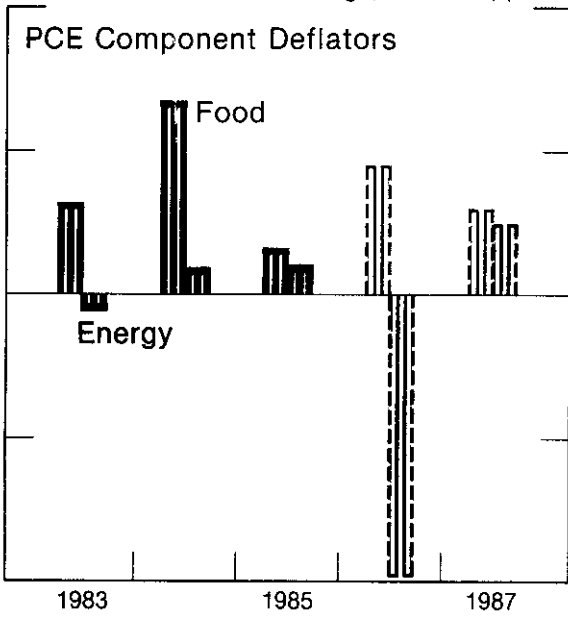
Change, Q4 to Q4, percent

1983	3.5
1984	4.4
1985	3.1
1986	2.5
1987	2.0

Labor Productivity**Compensation Per Hour and Unit Labor Costs**

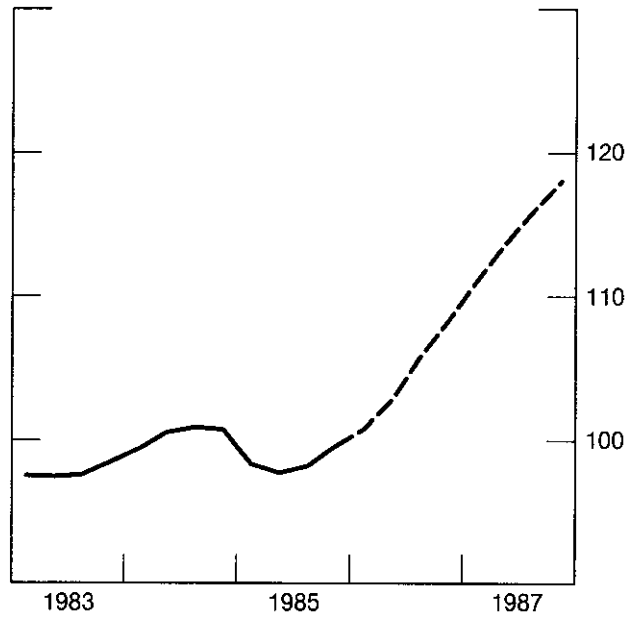
Food and Energy Prices

Change, Q4 to Q4, percent



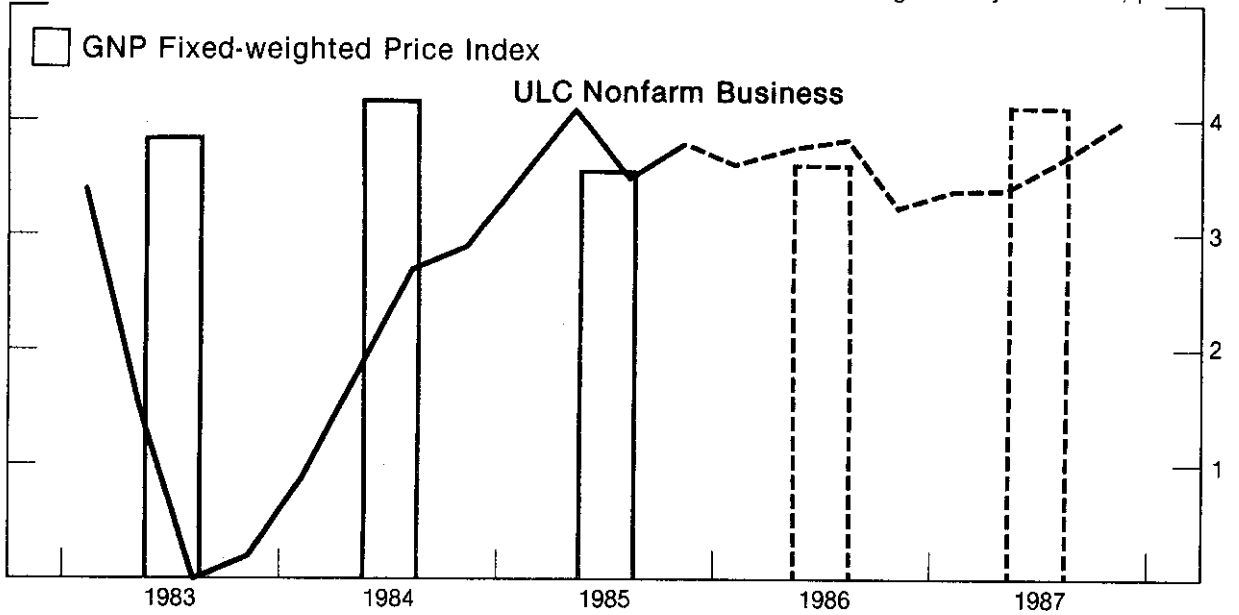
Nonpetroleum Import Prices

Unit Value Index 1982 = 100



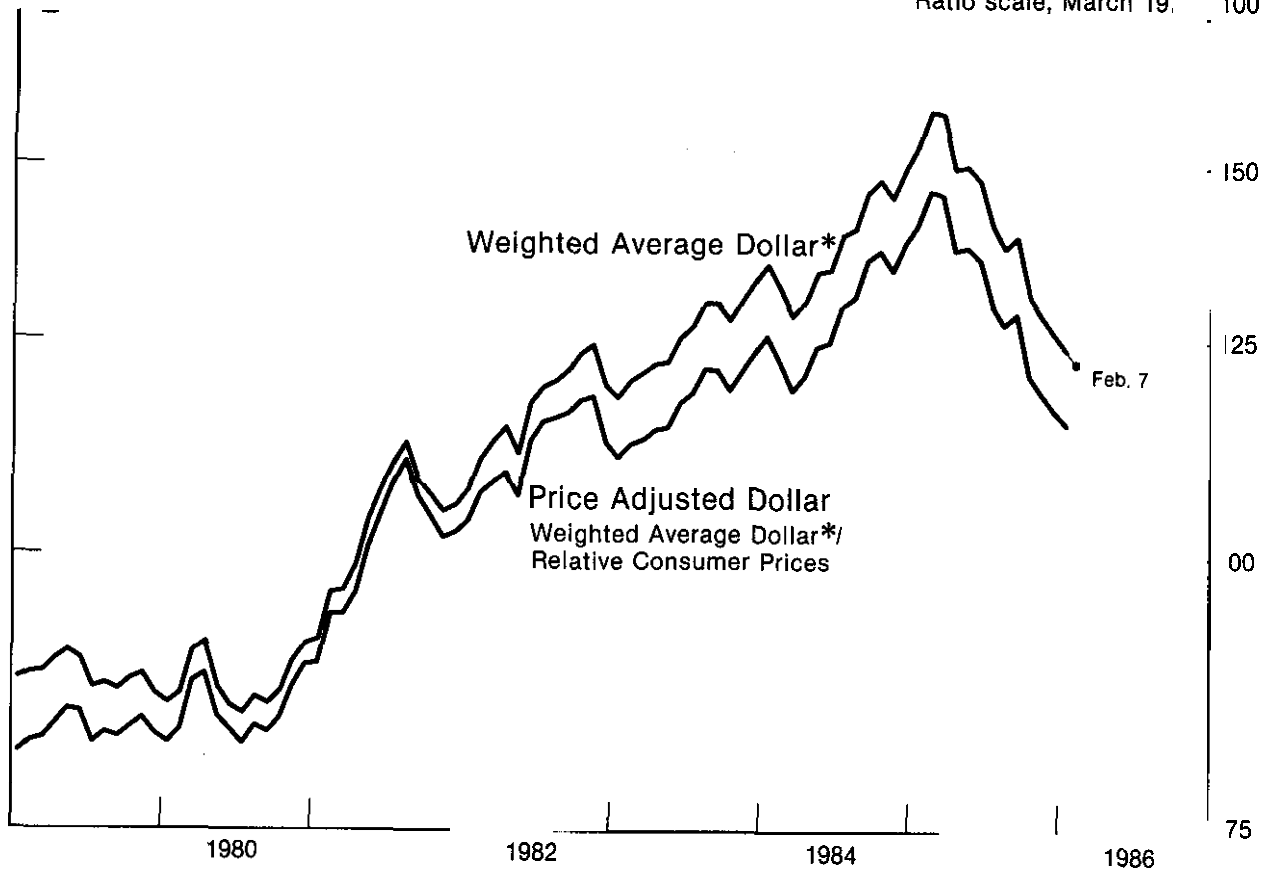
Prices and Unit Labor Costs

Change from year earlier, percent

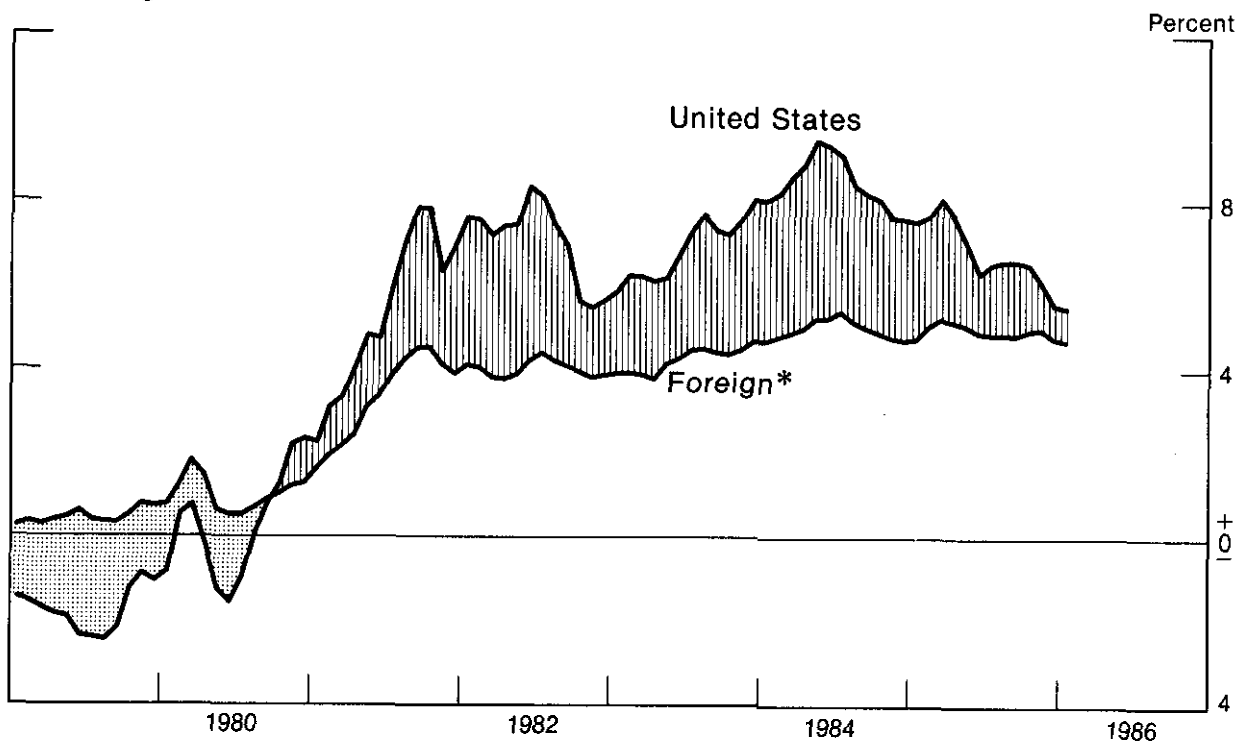


Foreign Exchange Value of the U.S. Dollar

Ratio scale, March 1971 = 100



Real Long-term Interest Rates**

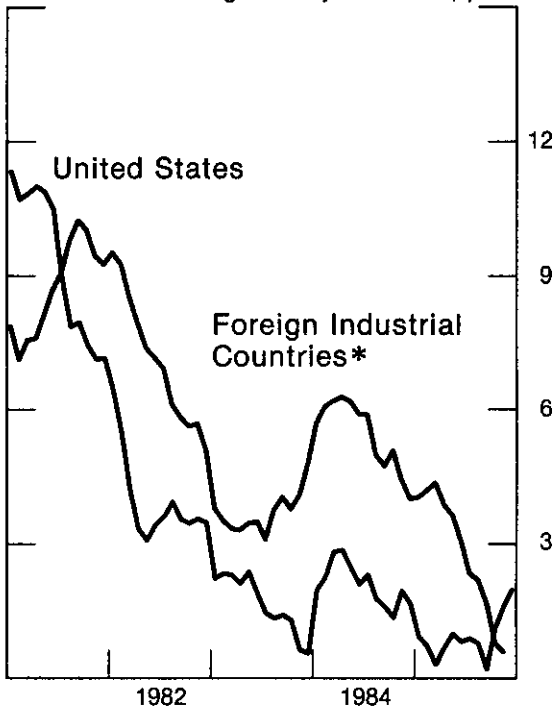


*Weighted average against or of foreign G-10 countries using total 1972-76 average trade.

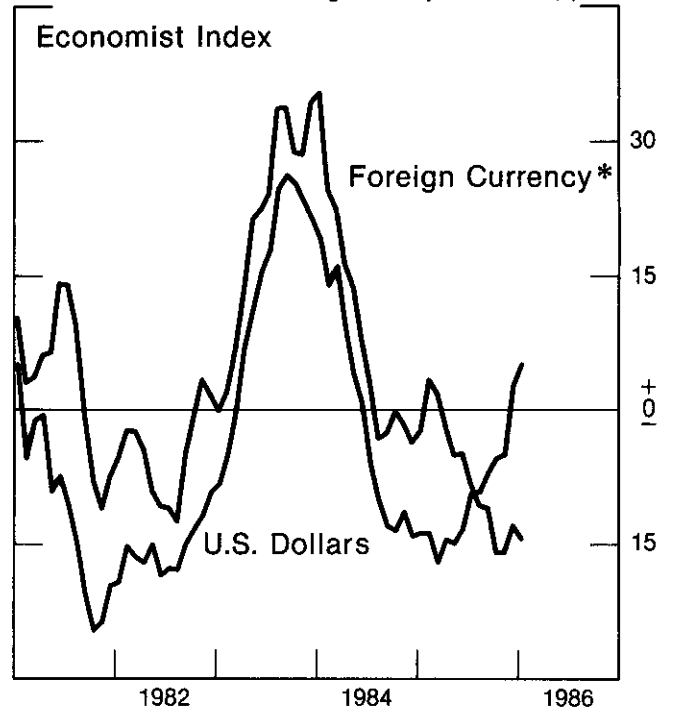
**Long-term government or public authority bond rates adjusted for expected inflation estimated by a 36-month centered moving average of actual inflation (staff forecasts where needed).

Wholesale Prices

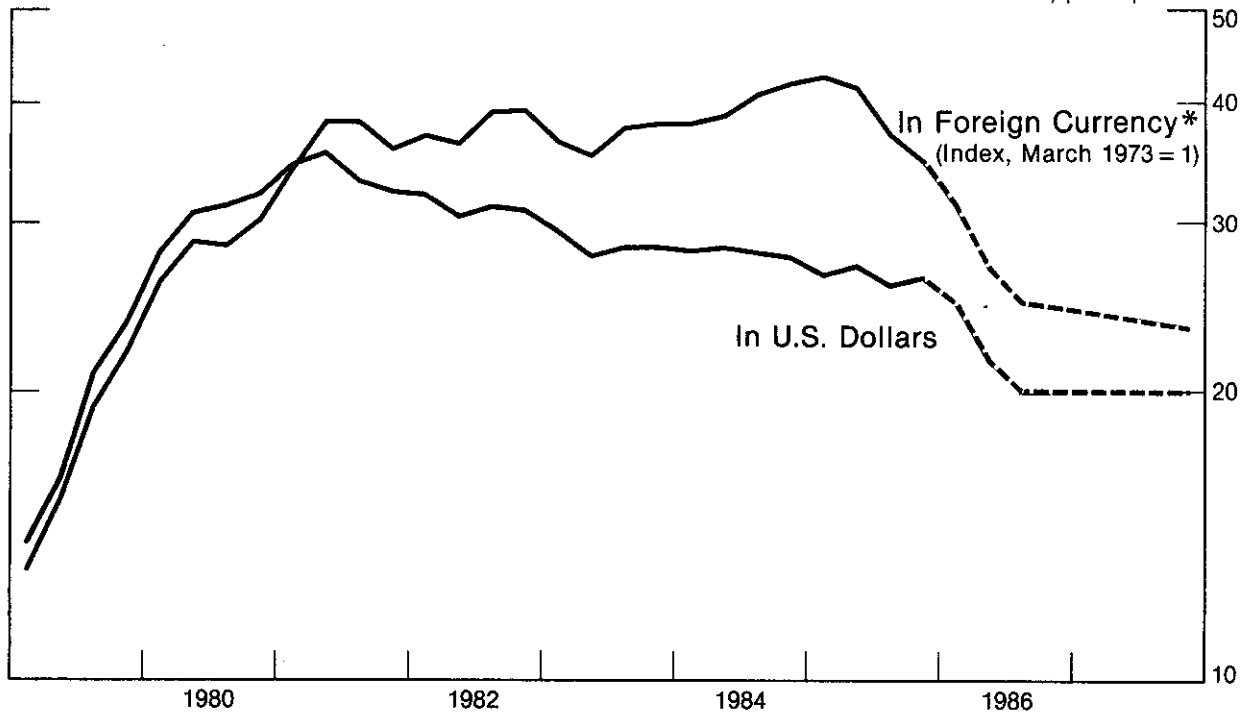
Change from year earlier, percent

**Commodity Prices**

Change from year earlier, percent

**U.S. Oil Import Price**

Ratio scale, price per barrel

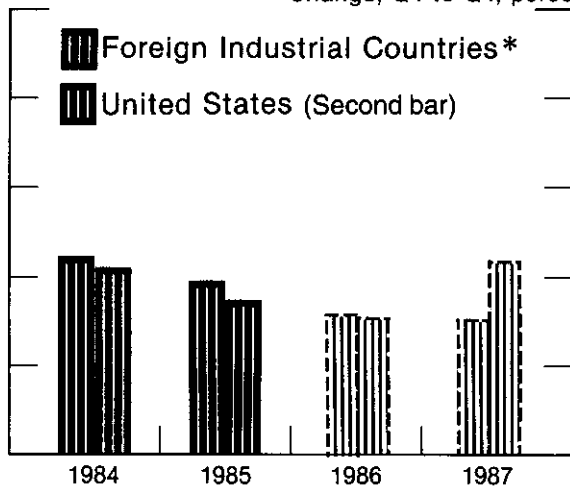


*Weighted average of the six major foreign industrial countries using total 1972-76 average trade.

Chart 16

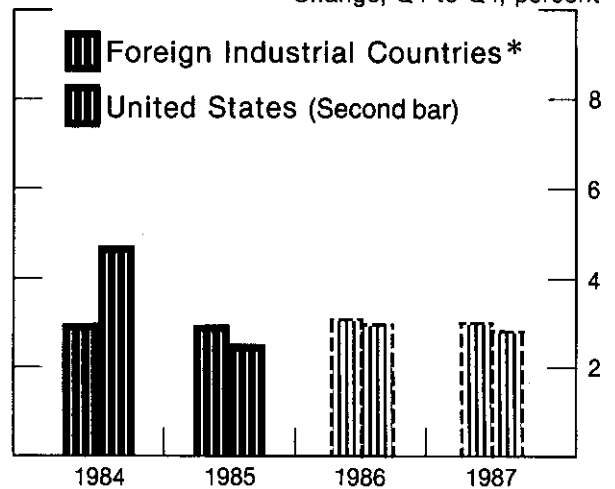
Consumer Prices

Change, Q4 to Q4, percent



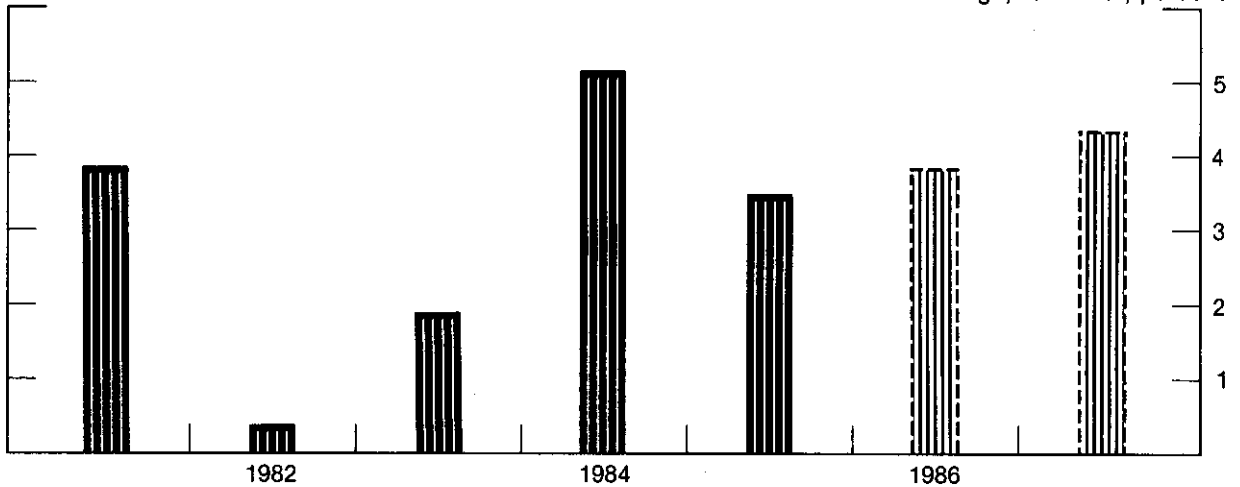
Real GNP

Change, Q4 to Q4, percent



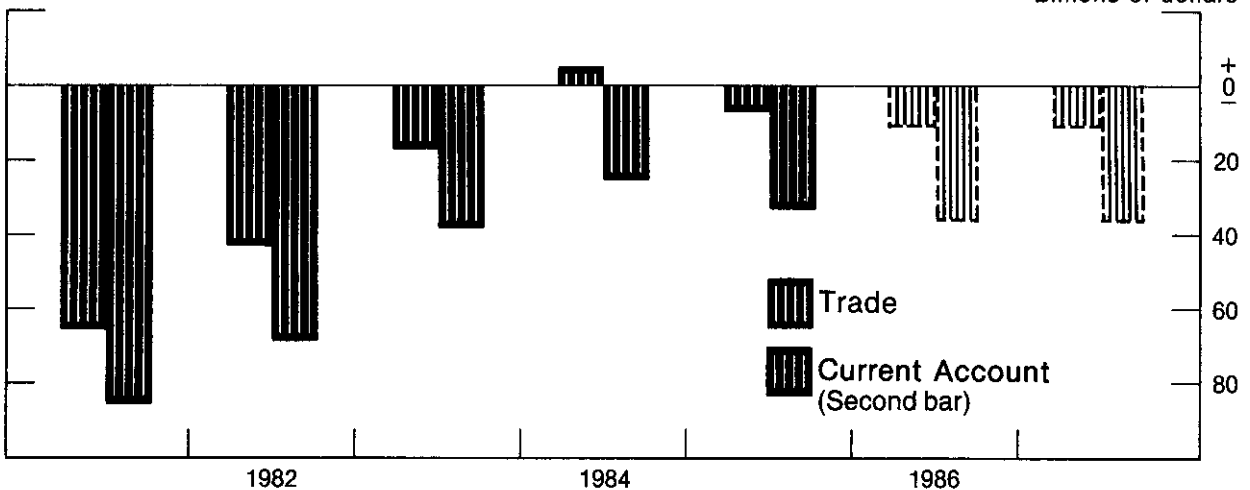
Real GDP Growth—Non-OPEC Developing Countries

Change, Q4 to Q4, percent



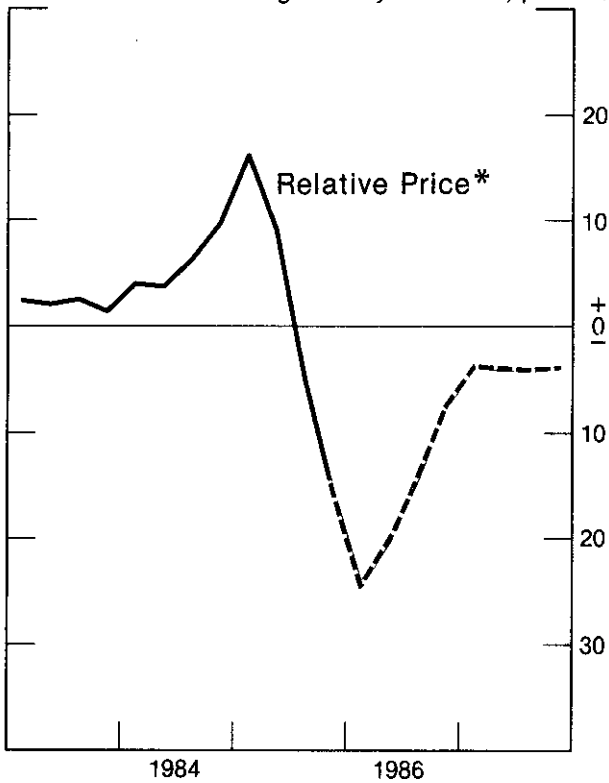
External Balances—Non-OPEC Developing Countries

Billions of dollars



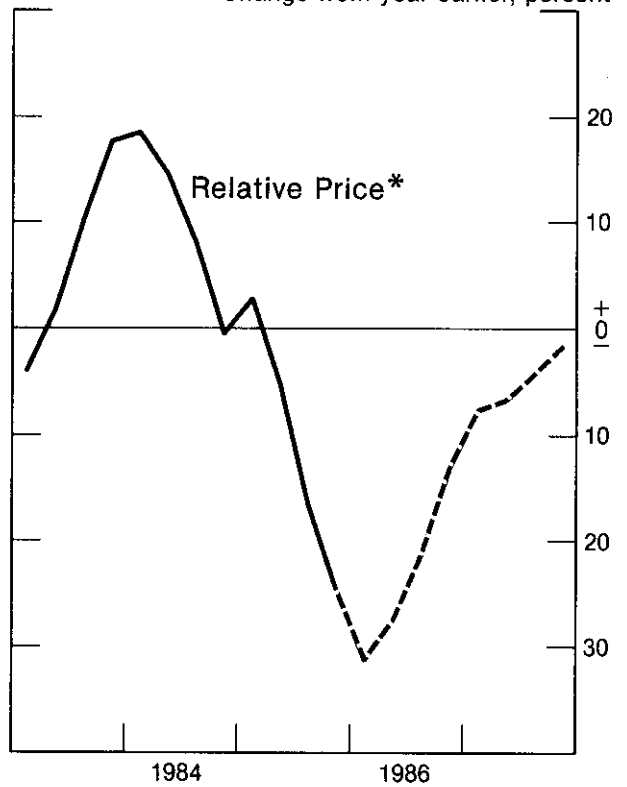
Nonagricultural Exports

Change from year earlier, percent



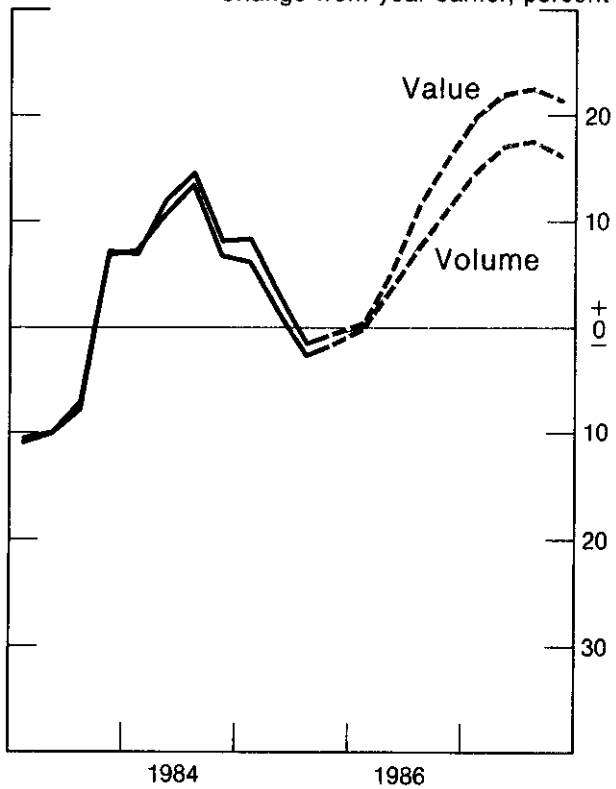
Agricultural Exports

Change from year earlier, percent



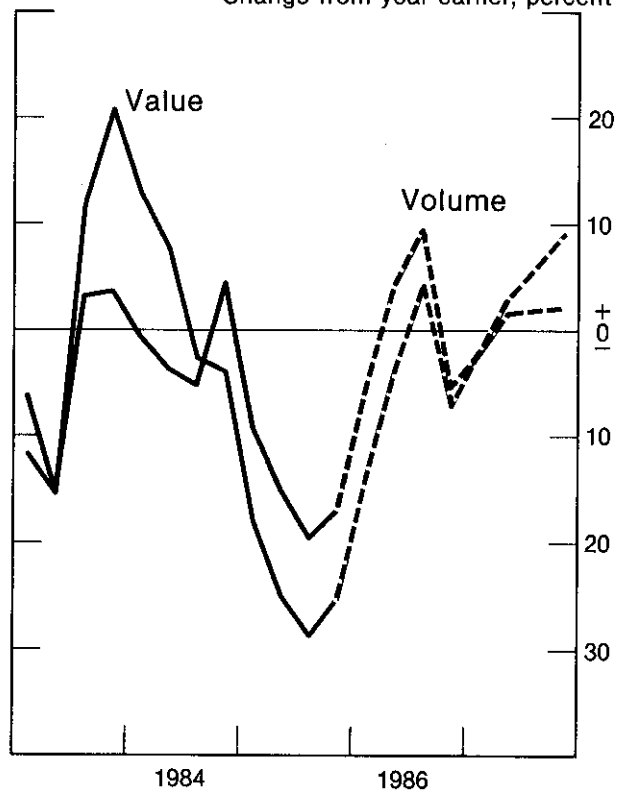
Nonagricultural Exports

Change from year earlier, percent



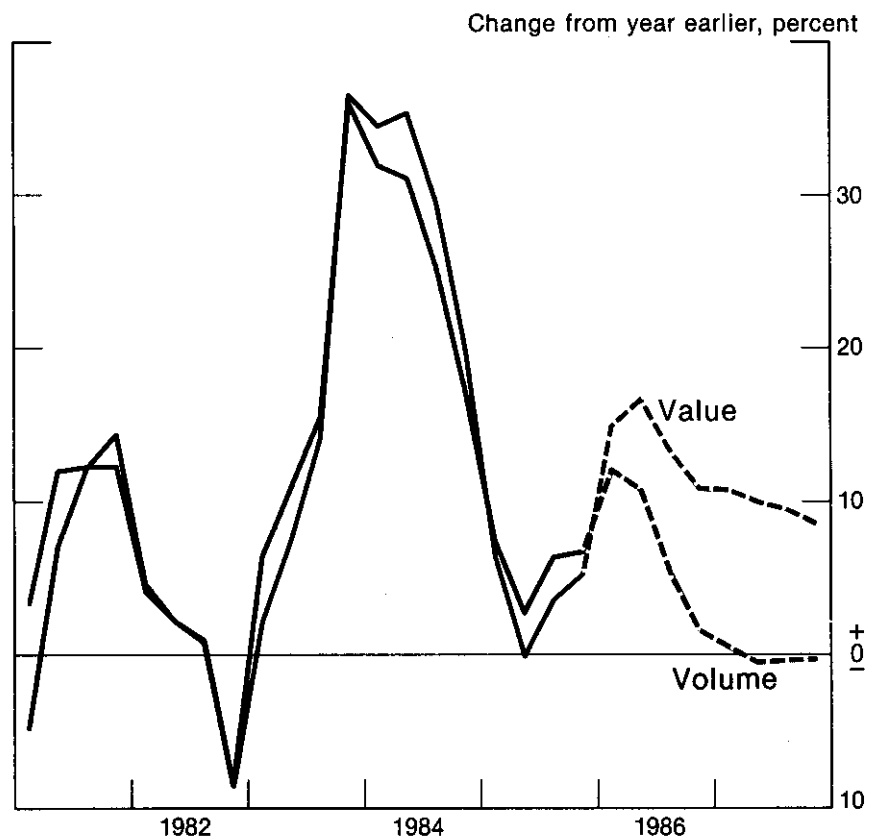
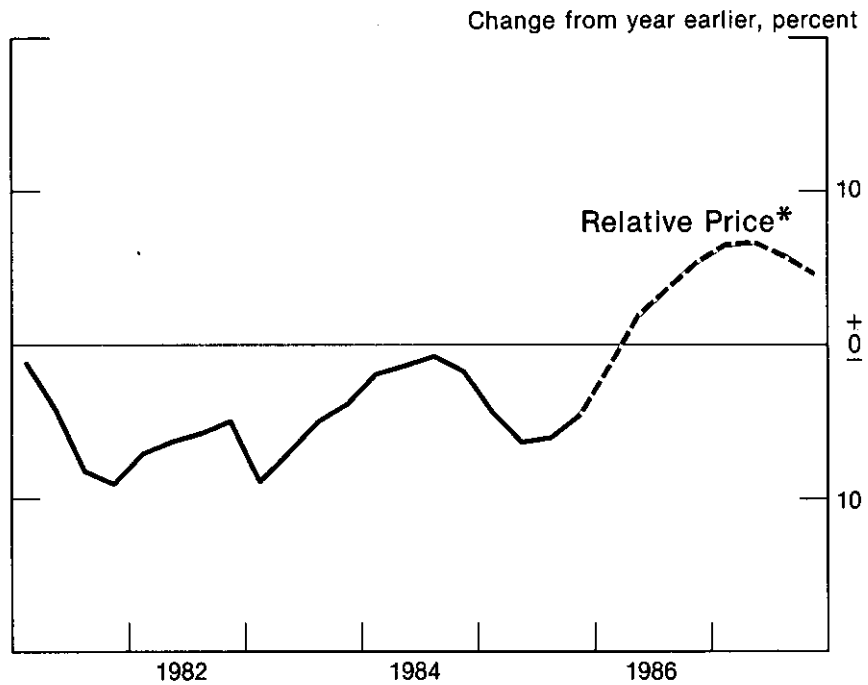
Agricultural Exports

Change from year earlier, percent



*Unit value divided by the average consumer price level in other G-10 countries expressed in U.S. dollars.

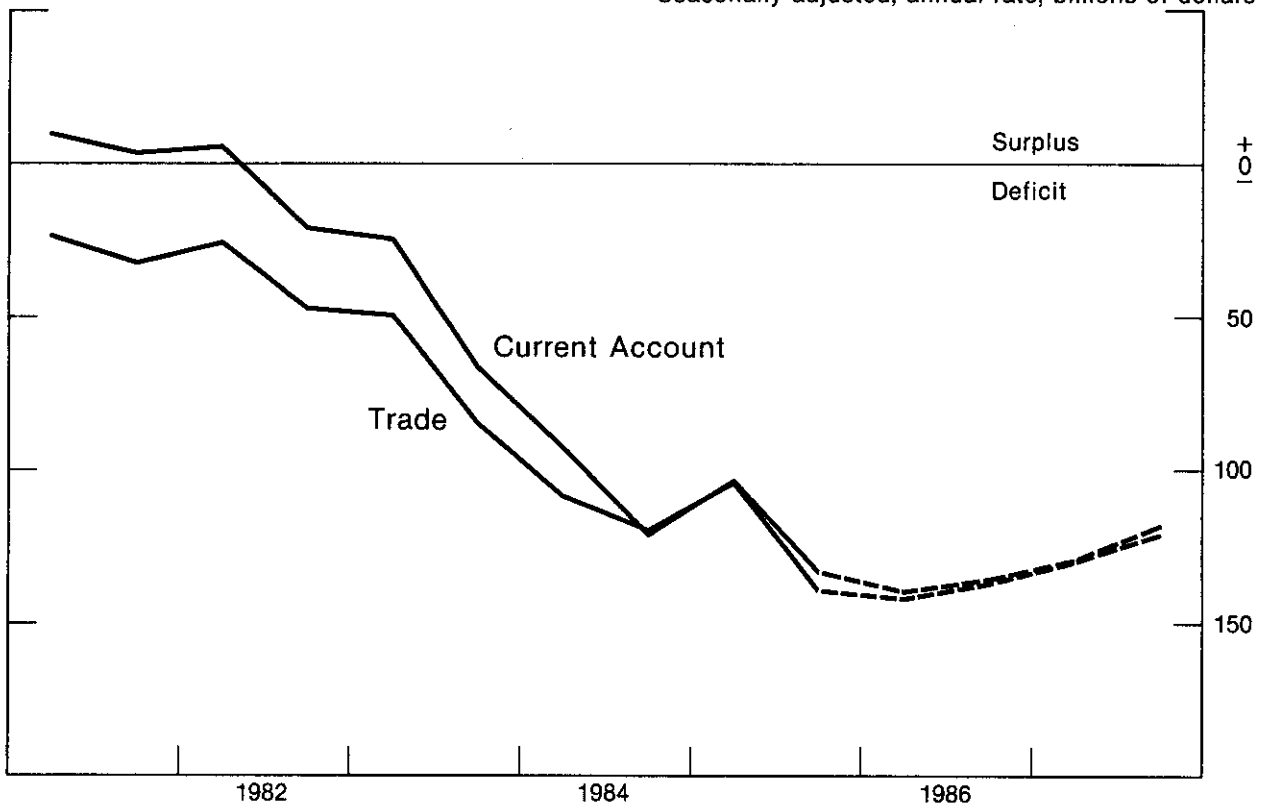
Non-oil Imports



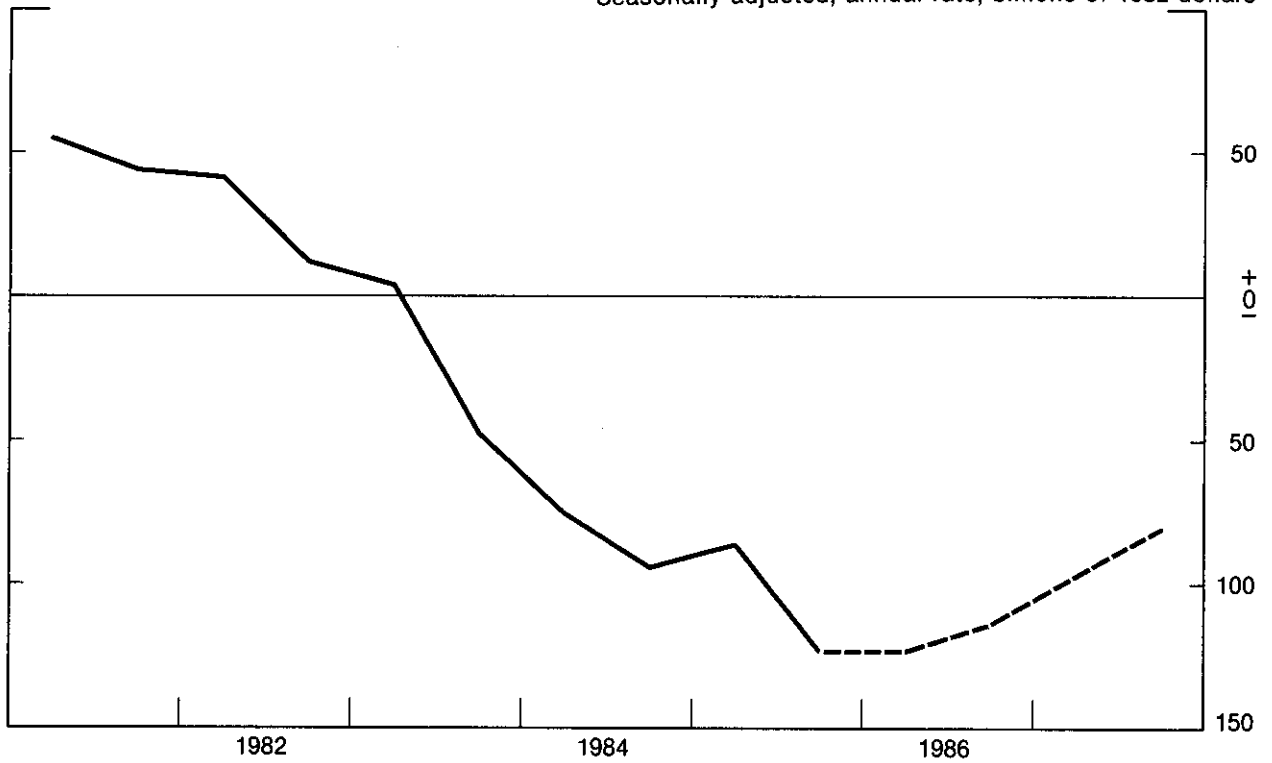
*Unit value divided by U.S. GNP fixed-weighted price index.

External Balances

Seasonally adjusted, annual rate, billions of dollars

**Real Net Exports of Goods and Services**

Seasonally adjusted, annual rate, billions of 1982 dollars



U.S. Capital Transactions

(Billions of Dollars; Net Inflows = +)

	1982	1983	1984	1985 ^e	1986 ^p
1. Net Private and Official Capital Flows	- 24	29	77	88	104
2. Private Capital Flows	- 17	30	82	98	100
3. U.S. Banking Offices	- 45	19	23	33	33
4. Bonds and Stocks	14	14	34	62	68
5. Direct Investment and Other Non-Bank Flows	13	- 4	25	3	- 1
6. U.S. and Foreign Official Transactions	- 7	- 1	- 5	- 10	4
7. Statistical Discrepancy	33	17	30	31	34
8. Balance on Current Account	- 8	- 46	- 107	- 119	- 138

e Estimated

p Projected

Impact of Alternative Assumptions

	1986	1987	1988
Change in Real GNP (%)			
Higher Money Growth	1 1/4	1	1/2
Lower Oil Prices	1/2	1/2	0
Less Fiscal Restraint	3/4	1/4	- 1
Change in GNP Deflator (%)			
Higher Money Growth	1/4	1	2 1/2
Lower Oil Prices	- 1/2	- 1/2	0
Less Fiscal Restraint	0	1/2	1
Unemployment Rate (Q4 level, %)			
Higher Money Growth	- 1/4	- 1	- 1 1/4
Lower Oil Prices	0	- 1/4	- 1/2
Less Fiscal Restraint	0	- 1/2	- 1/4

Higher Money Growth	=	M1 growth rate 1 1/2 % higher than staff forecast.
Lower Oil Prices	=	Oil prices \$5 per barrel lower than staff forecast.
Less Fiscal Restraint	=	No additional deficit-reducing actions beyond FY 1986 actions.

Forecast Summary for 1986

Percent change, annual average	Board Members		Presidents		Staff	Adminis- tration
	Range	Median	Range	Median		
Nominal GNP	5 to 7	6¼	6 to 8½	7¼	6½	8.0
Real GNP	2½ to 4	2¾	3 to 4½	3¼	3	4.0
GNP Deflator	2½ to 4	3¼	3 to 4½	3¾	3½	3.8
Average level, percent						
Unemployment Rate	6½ to 7	6¾	6½ to 7	6¾	6½	6.7

FOMC Projections for 1986

Reported to Congress July 16, 1985

	Range	Central Tendency
Percent change, Q4 to Q4		
Nominal GNP	5½ to 8½	7 to 7½
Real GNP	2 to 4	2½ to 3¼
GNP Deflator	3 to 5½	3¾ to 4¾
Average level, Q4, percent		
Unemployment Rate	6¾ to 7½	6¾ to 7¼